

GOURLEY'S CASE IN CONTRACTUAL CLAIMS

The House of Lords in *British Transport Commission v. Gourley*,¹ established the rule that in the award of damages to any plaintiff, deductions should be made for any sum which the plaintiff would have to pay in tax. The rationale behind this decision is that since damages are meant to compensate the plaintiff for his actual loss, his liability to pay any sum as tax must be taken into account. Two main conditions must be satisfied for this principle to be applicable:²

"First the earnings of profits in respect of which the claim is made must be subject to tax; Secondly, the sum awarded as damages must not be subject to tax in the plaintiff's hands."

The decision of the House of Lords has been subjected to criticism.³ In *Gourley's* case itself, a case based on tort for personal injuries, the plaintiff's damages was reduced from £37,720 to £6,695 after deduction of income tax and surtax. Despite the criticism levied against the decision, the principle has been applied in a number of subsequent cases on tort. It has also been extended to contractual claims arising from wrongful dismissals of employees⁴ but to date the principle has not been applied by the English Courts 'to the assessment of damages in commercial cases or cases of breach of contract generally.'⁵

The Federal Court decision of *Daishowa (M) Wood Products Sdn. Bhd. v. Kepong Wood Products Co. Sdn. Bhd.*⁶ therefore is the first case to be reported, where the principle in *Gourley's* case has been applied in a commercial case either in England or

¹ (1956) A.C. 185.

² Anson's Law of Contract, 25th Ed. at p. 569.

³ See Effect of Tax Liability on Damages, Seventh Report of the Law Reform Committee 1958, Cmnd. 501.

⁴ See generally Anson's Law of Contract, at page 569.

⁵ *Supra* at page 569.

⁶ [1980] 2 M.L.J. 68.

in Malaysia. But in a number of other cases in Malaysia and Singapore the application of this principle has been argued before the courts. One of the well-known cases where the *Gourley's* principle has been applied is the Singapore case of *Fox v. Ek Leong Hin*.⁷ This case concerned damages for wrongful dismissal. In the same year, the Malaysian Court in the case of *Drenam v. Greer*⁸ applied the principle in a case dealing with assessment of damages for personal injuries. Similarly, in *Yeap Cheng Hock v. Kajima-Taisei Joint Venture*⁹ another case on tortious liability, damages were reduced for tax liability. However, as pointed out above, *Gourley's* principle is inapplicable if there is any legislation under which the damages awarded to the plaintiff will be taxable. For this reason, the Privy Council in two decisions, one from Malaysia and the other from Singapore refused to apply *Gourley's* case, as the damages awarded were taxable under the Income Tax Laws of Malaysia or Singapore: see *Lim Foo Yong Ltd. v. Collection of Land Revenue*¹⁰ and *Raja Commercial College v. Gian Singh & Co.*¹¹

In *Daishowa (M) Wood Products Sdn. Bhd. v. Kepong Wood Products Co. Sdn. Bhd.* the appellants who were carrying on business in wood products entered into an agreement with the respondent whereby the appellants agreed to purchase all wood chips produced by the respondent for a period of 5 years. The agreement was renewable at the option of either party. The appellants installed two chipping plants in the respondent's factory but it was agreed that the respondent was responsible for all costs of producing wood chips and the maintenance of the plant. Subsequently, when the appellants requested the respondent to increase production, the respondent bought certain other machinery. As a result of some disagreement between the parties, the appellants informed the respondent that they were terminating the contract. The respondent sued the appellants for (a) loss of profits under the initial period stipulated in the contract and (b) for loss of profit which they would have earned if the contract had been renewed for a further period. The trial judge awarded damages on the first

⁷[1957] M.L.J. 1.

¹⁰[1963] W.L.R. 295.

⁸[1957] M.L.J. 77.

¹¹[1977] A.C. 312.

⁹[1973] 1 M.L.J. 230.

head but not the second. The appellants appealed to the Federal Court on the quantum of damages. The respondent cross-appealed for damages for anticipated loss of profits during the period. The Federal Court agreed with the finding of the trial judge that no damages should be awarded for the anticipated loss under the renewed period.^{1 2}

The Federal Court was therefore mainly concerned with the argument of the appellants that the trial judge had erred in not making sufficient deductions from the amount of damages awarded. The main contention of the appellants was that the learned trial judge should have deducted the tax liability under the rule in *Gourley's* case. They contended that in an action for damages for loss of profits assessment should be for net earning after tax and not on gross profits. One of the main arguments of the respondent was that,

"Gourley's case has no application in Malaysia as our income tax is very broad in concept and, therefore, different. Assuming that the tax law and the English tax law are similar *Gourley's* case ought to be rejected as a matter of policy."^{1 3}

The Federal Court, however, held that the Courts in Malaysia and Singapore have applied *Gourley's* principle in a number of cases and rejected the argument of the respondent.

"We can see no reason why *Gourley's* case is not applicable, especially now that the authority of the House of Lords has been asserted recently in *De Lasala v. De Lasala*."^{1 4}

It should be emphasised that none of the cases referred to by the Federal Court where *Gourley's* case was applied, were cases dealing with commercial contracts. The Federal Court appears not to have addressed its mind to this issue whether the rule in *Gourley's* case should be extended to commercial contracts.

^{1 2}See Survey of Malaysian Law 1979, Chapter on Contract.

^{1 3}[1980] 2 M.L.J. 68, 70.

^{1 4}[1979] 3 W.L.R. 390.

The Federal Court merely said:¹⁵

"The fact that the court have been never invited to apply the principle is not sound reason for not applying it."

On the interpretation of 'gain' in section 4(a) and 4(b) of Income Tax Act, the court held that only gains by way of income were taxable and not gains of capital nature. As such *Gourley's* case was held applicable and the damages were reduced. The court realised the difficulty in deducting an accurate sum which will be a sum payable by the repondent as tax.

"Just as it is impossible to assess with mathematical accuracy the amount of damages for future earning of profit, so it is also impossible to assess with the same accuracy the reduction to be made for taxation."¹⁶

The Federal Court then reduced the amount by \$250,000.

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¹⁵ [1980] 2 M.L.J. 60, 71.

¹⁶ *ibid.*